



IT'S ABOUT TRUST

A state budget process that restores public confidence



2009

This year's STATE BUDGET

– 85 days late and barraged with bipartisan criticism for its gimmicks – **is just one warning of the structural cracks in California's fiscal system.**

After steady economic growth since the short recession at the turn of the century – and as a potentially deep recession sets in – the state still owes more than \$18 billion that it borrowed to pay operating expenses from past years.

While the state budget should be a bridge to somewhere – better schools and safer neighborhoods – California's budgeting and fiscal systems are a bridge that no one should stand under.

To thrive, California's regional economies need schools and universities that produce a talented workforce and efficient infrastructure that supports the trade of goods, services and

information. Communities need healthy and sustainable environments. Families need safe neighborhoods and affordable housing. All Californians need a shot at self-sufficiency.

We live in the era of increasing innovation that has transformed our lives, and has created a dynamic global marketplace in which California must compete.



This market demands that private enterprise and public services get better every day. But our system for funding essential public services is obsolete, clogged with the unintended consequences of citizen initiatives and confounded by the workarounds intended to fix the glitches.

The budget process is one component of the overall public finance system that desperately needs modernization. The annual arm wrestling is over which programs (interest groups) will be cut and which will be increased, rather than strategically focusing available resources to effectively meet the highest priorities. Indeed, the discussion gets stuck on the overall amount of spending – with chronic borrowing (inexplicably) the only possible compromise.

Compare that reality with this imperative: The budget process must produce balanced plans that ensure adequate long-term investments. It must provide the ability and incentives to hold down the cost of providing services while directing dollars to programs that improve lives.



1 Look to the future

The annual budget process encourages short-term deals and must be replaced with multiyear budgeting that encourages smart investments.


Now, in this moment of true fiscal crisis, California must improve how it makes critical fiscal decisions. Drawing from the best practices used by other governments, California can create a process that produces:

- **Results and accountability.** Public services address critical public needs and the budget process is an essential tool for making sure those services are efficient and effective.
- **Stability and adequacy.** Fluctuations in the economy and the demands on government are inevitable, but the binging and purging of budgets is not. Better planning and money management can significantly reduce volatility in budgets.
- **Transparency and trust.** Fiscal choices are among the most important decisions elected officials make, so those choices need to be clearly understood and open to public deliberation and scrutiny, which will improve those decisions and stop the erosion of public confidence.



5 Create stability

Policy makers have made some progress, but fiscal policies must provide stability which is critical to efficient, effective and reliable public services.



2 Focus on priorities and outcomes

Budget decisions should be guided by what programs are trying to achieve and what must change to achieve those goals.

3 Create a culture of accountability

Policy makers should spend as much time reviewing what the public is getting for its money as they do deciding how that money will be spent.

4 Pay our own way

It is too easy to make promises that someone else must keep. From tax cuts to the full costs of entitlement programs, decisions with fiscal impacts must include associated spending cuts or revenue increases.

1 Looking to the Future

The problem: The one-year lifespan of the state budget puts too much emphasis on matching revenue and spending in a single year, rather than strategically investing public dollars to meet critical needs over the long-term.

What we have:

- Many policy choices have long-term implications: some increase demands on public budgets, while others have the potential to increase demands. Some create new economic opportunities, which will result in more jobs, increased wealth, and greater tax revenue. The current system discourages policymakers from considering the long-term implications – for better or worse – of the annual spending plan.
- An annual spending plan encourages policymakers to find short-term fixes to long-term problems; some of those fixes increase costs in the long-run.
- The public does not have a clear understanding of the long-term implications of fiscal choices, which enables policymakers to rely on gimmicks to achieve balanced budgets and contributes to the lack of public trust in state leaders.

What we need:

- A long-term fiscal forecast would allow the Governor, Legislature and the public to better understand the implications of policy and budget decisions and address the underlying issues that are increasing costs or reducing public value.
- The Governor, the Department of Finance and departments administering programs would need to address increasing costs and explore policy solutions that can reduce the demand for services, such as investing in prevention programs.
- A two-year process would free up time in the Legislature and the Department of Finance to focus on ways to hold down costs while improving access and quality of services.



What we CAN DO:

California needs a multiyear budgeting system to focus fiscal choices on the long-term implications of budget decisions while discouraging short-term solutions that push liabilities and difficult decisions into the future.

- **Priorities and goals.** The Governor's budget would establish priorities and identify goals and measurable objectives for public expenditures, beginning with major initiatives.
- **Two-year spending plan.** The budget proposal would include program-level information for the prior year, the current year, and the next two fiscal years. New initiatives would include a two-year estimate of implementation costs and methods for financing the initiatives.
- **Multiyear forecasts.** The budget proposal would graphically present the long-term costs anticipated for major components – such as education – as well as rapidly growing elements, such as prisons, or other obligations, such as unfunded pension liabilities.
- **Mid-course corrections to maintain balance.** The second year, the Governor would propose changes and adjustments to the two-year budget to maintain fiscal balance and adapt to changing economic and related circumstances.

Multiyear State Budgets

California's annual budget process – just 12 months long – provides little opportunity for effective planning and implementation. Planning for the next budget begins virtually weeks after a budget bill is adopted. The annual cycle infuses unnecessary uncertainty into the budget process and undermines efforts to take the long-term view, focus on implementation or manage for results. By extending the state budget to 24 months, public agencies – state, county, city, schools and others – are able to set goals that avoid the start-stop process of current agency funding.

Consider what a multiyear budget system would offer:

- A focus on the longer-range issues that drive public expenditures.
- More efficient use of government resources.
- A greater ability to focus on meaningful strategic goals.
- More time for legislative review and oversight.
- An ability to measure performance across state and local programs with a longer-term horizon.
- An obligation for government to realistically project revenues and expenses over a longer period.



“We must use time as a
tool, not as a crutch.”

John F. Kennedy



2 Focusing on priorities and results

The problem: By focusing on spending levels rather than results, the budget process does not encourage policymakers to set priorities and determine how resources can best be used to achieve those goals.

What we have:

- Without a focus on results, the default is for budgets to grow each year just to accommodate inflation. While some cost increases are inevitable, others can be controlled.
- Without a focus on results, budget decisions are focused on how much money to spend rather than how to spend that money, limiting the ability of policymakers to incorporate proven practices or to steer programs toward priorities.
- When cuts must be made, neither policymakers nor program managers have the capacity to reduce costs without simply eliminating or reducing access to services.

What we need:

- Major fiscal choices would be made predicated on an agreement regarding the desired results, enabling future leaders to assess whether to increase, continue or alter that course of action.
- Elected leaders would have a better way to consult with the public on the major fiscal choices before them and a way to communicate the value of those efforts.
- A results-based framework would enable policymakers to explore policy and other changes that are needed to improve the impact programs have on the lives of Californians.

The Industry Standard

This approach has been implemented at the federal, state and local levels and requires both executive and legislative leadership. Political leaders in other states have adapted performance or result-based approaches to accelerate progress toward desired goals – such as reducing high school dropouts – to control escalating costs, and to better make difficult budget decisions, both where to spend and where to cut. Other governments also have put in place performance-oriented reforms as part of fiscal reform, because the approach promises greater discipline, focus, and public understanding in fiscal decisions.



What we CAN DO:

The executive and legislative branches would develop a results-based process for major budget decisions, and in turn, for developing policies, managing programs and reviewing progress toward public goals.

- **Establishing goals and measuring outcomes.** Under the direction of agency secretaries, departments would establish strategic plans and performance metrics. Systematically, that framework would be matured to benchmark costs, establish budgets, align resources with priorities and publicly review programs to identify potential improvements. The framework would be the basis of the January budget proposal and legislative review of that proposal.
- **Implementing performance measurement.** The administration would create a unit to work with line departments and the Legislature to build agreement on the substance and the use of performance measurement in the budgeting process.
- **Institutionalizing a legislative role.** The Legislature would review and reach agreement with the Governor on the priorities and the scope of initiatives to pursue those priorities. It would review proposed changes in individual departments and programs to reach agreement on objectives and the allocation of resources to pursue them.

3 Creating a culture of accountability

The problem: While the Legislature spends months each year negotiating a spending plan, it does not have the capacity and it has not dedicated the time to reviewing whether programs are achieving their goals and what must change to improve results.

What we have:

- New programs are often launched with some evidence or expectation that they will address an important problem, but those decisions are not revisited to determine if the strategy was right, whether resources are adequate or need to be redirected, or if “bureaucratic” problems are limiting success.
- When resources are increasing, the Legislature lacks a systematic way of spending that money to strategically address the highest priorities. When revenue is down, it lacks the capacity to strategically reduce spending while preserving valuable services.

What we need:

- Public discussion of the outcomes we want to achieve, and our progress, will result in better oversight and public understanding of the challenge that must be addressed.
- Public understanding of fiscal options – and thus accountability – also would be enhanced.
- Under these proposals, the fiscal dialogue in the Legislature would be more focused and unified. Budget discussions would be held in a single public forum, with the administration, the Legislative Analyst’s Office, and all other interested parties present.

Public Trust

The two-thirds vote requirement to enact a budget is often cited as a critical problem in the current process. Extensive public research shows that a persistent majority of California taxpayers are willing to lower that threshold, but only if other reforms are enacted first to ensure accountability for results.



What we CAN DO:

The Legislature would systematically review programs, assess progress toward goals, explore potential changes in strategies that would reduce costs or improve results. These assessments would inform future policy and fiscal decisions by lawmakers, as well as management decisions and policy changes proposed by the administration.

- **A public process.** A period of time prior to the adoption of strategic plans and performance measures would allow the Legislature to consider those plans and measures. Within a specified period of time following legislative review unless challenged, the strategic plans and performance measures would become effective.
- **The legislative role.** The Legislature would develop a system of evaluating programs based on progress toward established goals and the barriers – in terms of resources, statutory requirements, organizational issues or management capacity – that are slowing progress.
- **A joint committee to ensure bipartisan and bicameral consensus.** The Joint Legislative Budget Committee would direct the Legislature's performance and accountability efforts. The committee would support the review of performance measures and the use of those measures in policy development, fiscal decisions and program reviews.

4 Paying our own way

The problem: The state's major spending obligations are growing faster than its revenue. The problem is caused and aggravated when the long-term fiscal impacts of policy decisions are not fully recognized when those commitments are made.

What we have:

- Policymakers find it easier to create new programs rather than improve existing ones, and there is no incentive to eliminate ineffective programs or those that are no longer a priority.
- Policymakers are encouraged to create small programs, with the hope that they will grow over time. In good years, base spending is ramped up, which sets up a conflict among these programs and their advocates when revenue declines.
- Similarly, tax cuts are imposed without offsetting decreases in spending or reliable increases in other sources of revenue. As the structural deficit has grown, state policymakers have shifted liabilities to other governments or into the future.

What we need:

- A policy that would create funding stability for major programs. Stable funding would allow policymakers and program managers to focus on steadily improving results.
- This would support efforts to set explicit priorities and make difficult decisions sooner.
- It would link policy and fiscal decisions, including the long-term potential for policy decisions to have positive or negative fiscal implications on government budgets and their programs.



What we CAN DO:

The costs of new policies or changes in existing policy would be identified so their costs can be accounted for in future budgets. Any policy change that increases costs must identify where the money will come from – either from new revenue or a reduction in other expenses.

- **Understanding costs.** Changes in state programs proposed by either the executive or the legislative branch must identify immediate long-term costs.
- **Consistency matters.** Program costs would be systematically reviewed to assess those that are exceeding projections, and whether the program should be revised, provided additional resources or scaled back. This process would be integrated into the general program of legislative oversight.
- **The Legislature as partner.** A legislative process would be set up to provide an independent analysis on all new or expanded programs that will have a significant out-year cost. The Joint Legislative Budget Committee would be an appropriate vehicle to accomplish this task.
- **Enforcing the practice.** New program legislation would be required to carry an appropriation or identify the revenue that will support the expenditure. A funding source other than the general fund should be identified. The objective is to have a requirement for the state budget process that parallels the constitutional provisions dealing with state/local mandates.

Creating stability

5

The problem: California's dependence on a highly progressive personal income tax results in General Fund revenues that are more volatile than in most states. Since 1990 revenues have fluctuated from a decrease of 5 percent to an increase of 23 percent. That volatility in revenue makes it difficult for state leaders to plan and effectively manage the state's resources.

What we have:

- When revenues are growing faster than the base budget, policymakers strive to lock in those new dollars to new initiatives, or to expand existing programs.
- Program advocates then strive to fend off cuts when revenues return to normal or decline.
- Program performance ultimately suffers from false starts, budget uncertainty, and ultimately unanticipated cuts.

What we need:

- Policies that distinguish between reliable revenue growth and "one-time" revenues.
- A reserve where the state saves one-time revenues for use on one-time needs.
- Improved use of a reserve to avoid the tendency to rely on revenue that may not be available from one year to the next.



What we CAN DO:

The new process would identify nonrecurring revenue and ensure that revenue is reserved for economic downturns or one-time uses such as tax rebates.

- **An executive-legislative process for determining nonrecurring revenues.** As part of the May budget revision, the Joint Legislative Budget Committee and the Department of Finance would estimate nonrecurring revenue for the current and budget year. In addition, the committee and department would certify the amount of revenue available for appropriation in the budget year, exclusive of nonrecurring revenue. The estimate of nonrecurring income would exclude any estimated amount required pursuant to Proposition 98.
- **Nonrecurring revenue would be held in reserve.** Nonrecurring revenues for the current fiscal year would be transferred into a subaccount within the Budget Stabilization Reserve.
- **Appropriate uses for nonrecurring revenue.** Upon certification by the Joint Legislative Budget Committee and the Department of Finance that revenues for the budget year fall below the long-term revenue trend, the Legislature could appropriate from the reserve to make up the gap. That legislation would be separate from the budget act and would require a two-thirds vote.

In addition, any effort to modernize California's revenue system needs to reduce the volatility inherent in the current sales and personal income tax system.

PAST PROPOSALS

PUBLIC INPUT

NATIONAL EXPERTS

**PRINCIPLES FOR
BUDGET PROCESS REFORM**

REFORM PROPOSALS



HOW WE GOT HERE

In early 2008, *California Forward* distilled problems with the state's budget process and identified broad principles for a public discussion on potential solutions. Comments on those principles were received during more than 50 meetings involving more than 5,000 Californians, as well as emails and numerous other conversations. "It's About Trust: A state budget that restores public confidence" is based on those comments.



California Forward is working with legislative leaders and state administrators to develop and refine these budget reforms into formal legislative proposals. The draft language is available on our home page at www.cafoward.org. *California Forward* is soliciting comments on these reforms in hopes of building a coalition of Californians committed to fixing the budget process.

While these reforms include some elements of the revenue system, additional changes in tax policy are warranted. Changes also are needed to strengthen the state-local fiscal relationship and local finance; *California Forward* expects to address those issues in future projects.



california forward

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“We can’t solve problems by using the same kind of thinking we used when we created them.” – Albert Einstein

Your comments are welcomed and will inform continued refinement of these proposals. We also would like your advice on how the reforms could be successfully implemented. We will distill that advice into an “operating manual” for executive and legislative officials.



www.caforward.org

